

Report
of the
Examination of
MGIC Reinsurance Corporation
Milwaukee, Wisconsin
As of December 31, 2002

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In accordance with the instructions of the Wisconsin Commissioner of Insurance (the "Commissioner"), a compliance examination has been made of the affairs and financial condition of:

MGIC REINSURANCE CORPORATION
Milwaukee, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of MGIC Reinsurance Corporation ("MGIC Re" or the "company") was conducted in 1998 and 1999 as of December 31, 1997. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain

documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

MGIC Reinsurance Corporation was incorporated under the laws of Wisconsin on February 21, 1985, and commenced business on March 1, 1985. The company is a wholly owned subsidiary of MGIC Investment Corporation ("MGIC Investment").

MGIC Re was organized to provide the affiliated insurer Mortgage Guaranty Insurance Corporation ("MGIC") with excess of loss reinsurance coverage on primary and pool residential mortgage guaranty insurance risks. The company's old book of business, now in run off, encompasses MGIC Re reinsurance of risks written by MGIC on a direct basis in all U.S jurisdictions except for six states from 1985 through 1996. The company's business was restructured in 1996 as a result of a restructure of business operations within the MGIC enterprise. MGIC Re's current active business consists of reinsurance of risks written on a direct basis by MGIC in 6 states that do not permit a direct writing insurer to recognize balance sheet credit for reinsurance that is ceded to a subsidiary insurer.

MGIC Re assumes from MGIC liability for mortgage guaranty net losses in excess of 25% of the indebtedness to the insured pursuant to five reinsurance treaties. The company derives all of its written business from its assumption of risks written by MGIC.

MGIC Re does not have any employees, and all of its business operations are performed by MGIC pursuant to an intercompany services agreement. Further discussion of the MGIC Investment Corporation holding company, description of MGIC Re's significant affiliates, and description of the company's intercompany agreements are included in the section of this report captioned "Affiliated Companies."

The company is licensed in the states of California, Illinois, Kansas, Maryland, New York, Texas, and Wisconsin.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Mortgage guaranty	<u>\$ 0</u>	<u>\$60,683,721</u>	<u>\$44,484</u>	<u>\$60,639,237</u>
Total All Lines	<u>\$ 0</u>	<u>\$60,683,721</u>	<u>\$44,484</u>	<u>\$60,639,237</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The MGIC Reinsurance Corporation board of directors consists of seven members, each of whom is elected annually from within the senior executive management of MGIC Investment Corporation. MGIC Re directors are elected to serve a one-year term. Each member of the MGIC Re board of directors also serves as a member of other boards of directors in the holding company group, and receives no additional compensation for services performed as a director of MGIC Re.

Currently the MGIC Re board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Curt S. Culver Nashotah, WI	President and Chief Executive Officer MGIC Investment Corporation	2004
John D. Fisk Kensington, MD	Executive Vice President – Strategic Planning MGIC Investment Corporation	2004
Joseph J. Komanecki Delafield, WI	Senior Vice President, Controller and Chief Accounting Officer	2004
Jeffrey H. Lane Glendale, WI	Senior Vice President, General Counsel and Secretary MGIC Investment Corporation	2004
J. Michael Lauer Elm Grove, WI	Executive Vice President and Chief Financial Officer MGIC Investment Corporation	2004
Patrick Sinks River Hills, WI	Senior Vice President – Field Operations MGIC Investment Corporation	2004
Joseph J. Ziino, Jr. Brookfield, WI	Senior Vice President – Regulatory Relations, Associate General Counsel and Assistant Secretary MGIC Investment Corporation	2004

Officers of the Company

MGIC Reinsurance Corporation officers are appointed by the company's board of directors at the annual meeting of the board, and serve a one-year term of office. Senior officers serving at the time of this examination are listed below. Each MGIC Re officer is employed by MGIC, and a portion of the MGIC compensation costs for the respective MGIC Re officers is allocated to MGIC Re through an affiliated servicing agreement. The annual compensation paid to MGIC Re officers in 2002 is reported in the concurrent examination report of MGIC, under the caption "Officers of the Company."

Name	Office
Curt S. Culver	President and Chief Operating Officer
J. Michael Lauer	Executive Vice President and Chief Financial Officer
Joseph J. Komanecki	Senior Vice President, Controller and Chief Accounting Officer
Jeffrey H. Lane	Senior Vice President, General Counsel and Secretary
Joseph J. Ziino, Jr.	Senior Vice President – Regulatory Relations Associate General Counsel and Assistant Secretary
James A. Karpowicz	Vice President and Treasurer

Committees of the Board

The MGIC Re bylaws allow for the formation of certain committees by the board of directors. The company had established one committee of the board at the time of the examination, listed below:

Securities Investment Committee

J. Michael Lauer
Joseph J. Komanecki
Joseph J. Ziino, Jr.

IV. AFFILIATED COMPANIES

MGIC Reinsurance Corporation is a member of a holding company system. The ultimate parent of the holding company system is MGIC Investment Corporation.

The following organizational chart depicts the relationships among the affiliates in the holding company group. Each respective subsidiary is a wholly owned affiliate within the MGIC enterprise except as noted otherwise. A brief description of the significant affiliates of MGIC Reinsurance Corporation and a summary of significant affiliated agreements follows the organizational chart.

Organizational Chart As of December 31, 2002

- MGIC Investment Corporation
 - Mortgage Guaranty Insurance Corporation
 - MGIC Reinsurance Corporation of Wisconsin
 - MGIC Mortgage Insurance Corporation
 - MGIC Mortgage and Consumer Asset II LLC (Note #1)
 - MGIC Credit Assurance Corporation
 - MGIC Assurance Corporation
 - MGIC Assurance Corporation Segregated Account
 - MGIC Reinsurance Corporation of Vermont
 - GHR Systems, Inc. (12% ownership interest)
 - MGIC Indemnity Corporation
 - eMagic.com
 - Sherman Financial Group LLC (45.5% ownership interest)
 - Equix Financial Services LLC (70.5% ownership interest)
 - MGIC Mortgage and Consumer Asset I LLC (Note #1)
 - CMI Investors LP 5 (99% ownership interest)
 - CMI Investors LP 8 (99% ownership interest)
 - CMI Investors LP 9 (99% ownership interest)
 - CMI Investors LP 2 (99% ownership interest)
 - Credit-Based Asset Servicing & Securitization LLC (45.9% ownership interest)
 - Litton Loan Servicing LP
- MGIC Reinsurance Corporation
- MGIC Mortgage Reinsurance Corporation
- MGIC Residential Reinsurance Corporation
- MGIC Mortgage Marketing Corporation
- MGIC Investor Services Corporation
- MGIC Insurance Services Corporation
- MGIC Mortgage Securities Corporation
- MGIC OneStop Holdings LLC
 - OneStop Shop, Inc. (24% ownership interest)

Note # 1: MGIC Mortgage and Consumer Asset II LLC holds a 1% ownership interest in CMI Investors LP's; the remaining 99% interest is held in MGIC Mortgage and Consumer Asset I LLC.

MGIC Investment Corporation (“MGIC Investment”)

MGIC Investment was incorporated in Wisconsin on June 22, 1984 under the name Management Financing Corporation. MGIC Investment was established as a holding company to consolidate the ownership and capitalization of the legal entities within the MGIC enterprise. The initial capital funding of Management Financing Corporation was provided by The Northwestern Mutual Life Insurance Company and by senior executive officers of MGIC. The holding company name was changed to MGIC Investment Corporation effective March 1, 1985. An initial public offering of MGIC Investment common capital stock was completed in August of 1991, and a second public offering was completed in June 1992. The issued and outstanding shares of MGIC Investment common capital stock are traded on the New York Stock Exchange.

As of February 15, 2003, Legg Mason, Inc., an investment management company, held a 14.59% ownership interest in the outstanding MGIC Investment Corporation capital stock, and Janus Capital Management LLC held a 12.16% ownership interest in MGIC Investment. Officers and directors of MGIC Investment Corporation, who comprise 17 individual share holders, in aggregate held 1.26% ownership interest in MGIC Investment. Interests held by officers and directors included 31,085 share units held under MGIC Investment Corporation's directors' deferred compensation plan for which the holders currently do not have rights to exercise investment or voting power. Other investors, each of whom individually owned less than a 5% interest in MGIC Investment, held the remaining outstanding shares of MGIC Investment common capital stock.

The MGIC enterprise is principally engaged in writing mortgage guaranty insurance on residential mortgage loans. MGIC Investment Corporation insurance subsidiaries provide mortgage guaranty insurance to mortgage lenders, and its non-insurance operating subsidiaries provide products and services to the mortgage finance industry, including contract underwriting, mortgage portfolio analysis, secondary market mortgage brokerage and trading services, and internet-based technology services.

As of December 31, 2002, MGIC Investment's consolidated GAAP basis audited financial statements reported total assets of \$5,300,303,000, total liabilities of \$1,905,111,000,

and total shareholders' equity of \$3,395,192,000. Operations for 2002 provided reported net income of \$629,191,000.

Mortgage Guaranty Insurance Corporation ("MGIC")

MGIC was incorporated under the laws of Wisconsin on February 20, 1979 as Liberty Mortgage Insurance Corporation ("LMIC"). LMIC was originally owned by Verex Corporation and was acquired by MGIC Investment Corporation in November 1984. The name Liberty Mortgage Insurance Corporation was changed to Mortgage Guaranty Insurance Corporation on March 1, 1985, when MGIC began writing new business.

MGIC formerly had two classes of issued and outstanding common capital stock, Class A common stock and Class B common stock. MGIC Investment Corporation retained ownership of the MGIC Class B common stock, and effective September 30, 1985 contributed 100% of the MGIC Class A common stock to the former MGIC Investment subsidiary Mortgage Guaranty Reinsurance Corporation ("MGRC"). Effective May 25, 1999, MGRC was dissolved pursuant to a plan of voluntary dissolution and liquidation approved by the Commissioner. Upon the dissolution of MGRC, all 35,000 issued and outstanding shares of MGIC Class B common stock held by MGIC Investment were redeemed at a price of \$1,000 per share, and the remaining assets and liabilities of the liquidated MGRC legal entity including 100% of the MGIC Class A common capital stock transferred to MGIC Investment Corporation. MGIC's capital stock presently is comprised solely of one class of common stock, wholly owned by MGIC Investment Corporation.

MGIC issues residential mortgage guaranty insurance in 50 states, the District of Columbia, Puerto Rico, and Bermuda. MGIC serves as the lead operating company in the MGIC group, and provides administrative and managerial services to its affiliates. MGIC's direct and indirect costs incurred in providing services to its affiliates are allocated to the respective affiliates pursuant to intercompany services agreements. Excess of loss insurance coverages on risks written by MGIC are ceded to four MGIC affiliate insurers to enable MGIC to comply with statutory restrictions in some states that limit an insurer's net retention of mortgage guaranty insurance for any one risk to not more than 25% of the total indebtedness to the insured.

As of December 31, 2002, MGIC's statutory financial statements reported total admitted assets of \$5,748,861,544, total liabilities of \$4,200,854,153, and policyholders' surplus of \$1,548,007,391. Operations for 2002 provided reported net income of \$256,475,739.

MGIC Reinsurance Corporation of Wisconsin ("MRCW")

MRCW was incorporated under the laws of Wisconsin on February 15, 1996, and commenced operations on April 1, 1996. MRCW was established to provide reinsurance to MGIC for primary and pool mortgage guaranty policy liabilities in excess of 25% of the total indebtedness to the insured, for mortgage guaranty policies written in all jurisdictions except six states. MRCW assumes all of its business from MGIC, and does not cede any business.

As of December 31, 2002, MRCW's statutory financial statements reported total admitted assets of \$648,397,711, total liabilities of \$200,721,132, and policyholder's surplus of \$447,676,579. Operations for 2002 provided reported net income of \$27,646,621.

MGIC Mortgage Insurance Corporation ("MMIC")

MMIC was incorporated under the laws of Wisconsin on April 30, 1987. MMIC was established to be an insurer that maintains a Standard and Poor's Corporation AAA claims paying ability rating, to provide the MGIC group with the facility to write mortgage guaranty insurance on loans that require the insurer to be rated AAA. MMIC assumes coverages issued by MGIC, and does not write any direct insurance business. MMIC has not assumed any new risks from MGIC for the past several years.

Prior to 1996, MMIC was a wholly owned subsidiary of MGIC. In 1996 MGIC contributed 100% of the common capital stock of MMIC to MGIC Reinsurance Corporation of Wisconsin.

As of December 31, 2002, MMIC's statutory financial statements reported total admitted assets of \$79,579,265, total liabilities of \$11,512,325, and policyholder's surplus of \$68,066,940. Operations for 2002 provided reported net income of \$4,535,872.

MGIC Credit Assurance Corporation ("MCAC")

MCAC was organized under the laws of Wisconsin on April 30, 1997, and commenced business on May 21, 1997. MCAC is a wholly owned subsidiary of MGIC, and was

established to write mortgage guaranty insurance for lenders in certain states on second mortgages and home equity lines of credit. MCAC commenced writing direct business in 1998, and terminated writing new business effective January 1, 2002. MCAC's current portfolio of insurance risks consists solely of renewal business on existing policies, and MCAC's entire book of business is in run-off.

As of December 31, 2002, MCAC's statutory financial statements reported total admitted assets of \$36,120,251, total liabilities of \$14,915,547, and policyholder's surplus of \$21,204,704. Operations for 2002 resulted in a reported net loss of \$5,573,957.

MGIC Assurance Corporation ("MAC")

MAC was organized under the laws of Oklahoma in 1937 under the name Insurers Indemnity and Insurance Company, and was subsequently renamed Financial Security Assurance, Inc. of Oklahoma ("FSAOK"). FSAOK was acquired by MGIC in 1995, and effective November 18, 1996, MAC redomesticated to Wisconsin and adopted the name MGIC Assurance Corporation.

MAC established a segregated account in 1997 pursuant to the requirements of s. 611.24 (1), Wis. Statutes and s. Ins 3.09 (12)(g), Wis. Adm. Code, through which MAC is authorized to conduct junior lien guaranty insurance business. MAC commenced writing insurance on second mortgages and home equity lines of credit in 1997. MAC terminated writing new business effective January 1, 2002. MAC's current portfolio of insurance risks consists solely of renewal business on existing policies written through the segregated account, and MAC's entire book of business is in run-off.

In 1997, all of the issued and outstanding capital stock of MAC was contributed to the MGIC subsidiary insurer MGIC Surety Corporation ("Surety"). MGIC Surety Corporation was merged with and into MGIC effective November 30, 2002. Upon the merger of Surety, the assets and liabilities of MGIC Surety Corporation, including 100% of the issued and outstanding capital stock of MAC, transferred to MGIC.

As of December 31, 2002, MAC's statutory financial statements reported total admitted assets of \$35,284,592, total liabilities of \$12,516,380, and policyholder's surplus of \$22,768,212. Operations for 2002 produced net income of \$232,734.

MGIC Reinsurance Corporation of Vermont ("MRCV")

MRCV was established in December 1999 as a Vermont-domiciled insurer, to operate as a sponsored captive insurance company pursuant to Title 8, Chapter 141 of the State of Vermont Statutes. The Vermont Statutes permit a licensed insurer and participating sponsors to establish a sponsored captive reinsurance company to reinsure business written by the licensed insurer. MRCV reinsures MGIC mortgage guaranty risks on loans that were originated, purchased, or serviced by mortgage lenders which participate in MRCV captive reinsurance. For the business assumed by MRCV on behalf of a participating sponsor, MRCV establishes a protected cell account in which assets of each such participant are separately maintained and accounted for with respect to the participant's liabilities for mortgage guaranty risks assumed by the participant. A separate participation agreement is established between MRCV and each respective participant. By establishing a participation agreement with MRCV, a lender which desires to engage in captive reinsurance is able to participate as a sponsored captive and is not required to establish a separate insurance or reinsurance legal entity. As of year-end 2002, MRCV had nine participation agreements in effect.

As of December 31, 2002, MRCV's statutory financial statements reported total admitted assets of \$3,971,536, including \$1.3 million of trust assets, total liabilities of \$1,073,387, and policyholder's surplus of \$2,898,149. Operations for 2002 produced net income of \$776,615.

MGIC Indemnity Corporation ("MIC")

MGIC Indemnity Corporation is a Wisconsin-domiciled mortgage guaranty insurer originally incorporated in Wisconsin in 1956 under the name Mortgage Guaranty Insurance Corporation ("Old MGIC"). Old MGIC was a subsidiary of the former MGIC Investment Corporation ("Old MGIC Investment," the pre-1985 MGIC Investment Corporation). Ownership of Old MGIC Investment and its subsidiaries including Old MGIC was purchased by Baldwin-United Corporation ("Baldwin") in 1982. Baldwin became financially impaired in 1983 due in part to

excess corporate debt, and filed petition for voluntary reorganization under Chapter 11 of the Federal Bankruptcy Code.

In 1984 the Commissioner approved a plan (the "Plan") whereby the ongoing successful business enterprise of Old MGIC could be protected from the bankruptcy of Baldwin and be continued in a successor legal entity. Pursuant to the Plan, effective February 28, 1985 the business operations of Old MGIC were transferred to a successor insurer named Mortgage Guaranty Insurance Corporation (the present-day MGIC), Old MGIC changed its name to Wisconsin Mortgage Assurance Corporation ("WMAC"), and WMAC entered into court-ordered liquidation proceedings under the supervision of the Commissioner.

Under the 1985 liquidation proceedings, WMAC discontinued issuance of new insurance business, its existing book of business entered run-off status managed by the present day MGIC, and 100% of WMAC's existing net retained liability for insurance risks was ceded to a group of international reinsurers under quota share reinsurance treaties. In December 1998, the WMAC liquidation proceedings were terminated and WMAC entered rehabilitation proceedings. Mortgage Guaranty Insurance Corporation (the present-day MGIC) purchased WMAC as of December 31, 1998 under a plan of rehabilitation approved by the Commissioner. WMAC changed its name to MGIC Indemnity Corporation effective June 1, 2000. MIC has not written any new business since 1985, and its entire portfolio of business is comprised of renewal policies in run-off. All claims have been paid by WMAC or its reinsurers, and only a small amount of insurance inforce remains in run-off.

As of December 31, 2002, MIC's statutory financial statements reported total admitted assets of \$20,154,586, total liabilities of \$273,834, and policyholder's surplus of \$19,880,752. Operations for 2002 provided reported net income of \$646,092.

eMagic.com, LLC ("eMagic")

eMagic.com, LLC was organized in February 2000 to provide business-to-business interactive electronic services to the mortgage finance industry. eMagic products and services provide an internet technological facility to lenders, mortgage service providers, and other

mortgage institutions, to access wholesaler/investor products and vendor services that pertain to the origination of mortgage loans.

As of December 31, 2002, eMagic.com, LLC's GAAP basis financial statements reported total admitted assets of \$1,753,000, total liabilities of \$1,148,000, and members' equity of \$604,000. Operations for 2002 resulted in a reported net loss of \$10,577,000.

Credit-Based Asset Servicing & Securitization LLC ("C-BASS")

C-BASS is a joint venture in which MGIC had a 45.9% ownership interest as of year-end 2002. The venture was formed in July 1996 to engage in the acquisition and resolution of delinquent or otherwise credit sensitive single family mortgage loans. C-BASS purchases, sells, and securitizes residential mortgage loans, seller-financed notes, mortgage-backed securities, and other asset-backed debt securities.

As of December 31, 2002, C-BASS's GAAP basis audited financial statements reported total assets of \$1,754,392,000, total liabilities of \$1,384,855,000, and owners' equity of \$369,537,000. Operations for 2002 provided reported net income of \$138,335,000.

MGIC Mortgage Reinsurance Corporation ("MMRC")

MMRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business activity on that date. MMRC was organized to provide MGIC with excess of loss reinsurance coverage. MMRC provides reinsurance to MGIC on mortgage guaranty primary and pool coverage in excess of 25% of the total indebtedness to the insured on business written in six states. MMRC's reinsurance on any loan is limited to a maximum of 25% of the total indebtedness to the insured. MMRC assumes all of its business from MGIC, and does not cede any business.

As of December 31, 2002, MMRC's statutory financial statements reported total admitted assets of \$16,101,360, total liabilities of \$2,088,409, and policyholder's surplus of \$14,012,951. Operations for 2002 provided reported net income of \$1,159,246.

MGIC Residential Reinsurance Corporation ("MRRC")

MRRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business on that date. MRRC was organized to provide MGIC with excess of loss reinsurance

coverage. MGIC Residential Reinsurance Corporation provides reinsurance to MGIC on mortgage guaranty primary and pool coverage in excess of 25% of the total indebtedness to the insured on business written in six states. MRRC reinsurance on any loan is limited to a maximum of 25% the total indebtedness to the insured. MRRC assumes all of its business from MGIC and does not cede any of its business.

As of December 31, 2002, MRRC's statutory financial statements reported total admitted assets of \$15,925,334, total liabilities of \$2,070,188, and policyholder's surplus of \$13,855,146. Operations for 2002 provided reported net income of \$1,085,987.

Affiliated Agreements

1. 1986 Tax Sharing Agreement – The MGIC enterprise maintains a Tax Sharing Agreement whereby MGIC Investment Corporation and specified subsidiaries that qualify under the Internal Revenue Code join in filing a consolidated federal income tax return. Tax benefit or liability attributed to each respective legal entity under the consolidated income tax return is based on the amount of benefit or liability that would otherwise be applicable if the respective legal entity filed a separate United States Corporation Income Tax Return. For purposes of income tax sharing, each subsidiary computes its own income on a separate company basis, and each computes its own respective taxes by applying on a separate company basis the provisions of the Internal Revenue Code. The Tax Sharing Agreement is amended from time-to-time as necessary to add or delete the participation of applicable affiliated entities, and currently provides that each of the Wisconsin-domiciled MGIC insurers is a participant in the agreement.
2. 1996 Servicing Agreement – MGIC maintains a Servicing Agreement under which MGIC performs management and administrative services for the benefit of various affiliates within the MGIC holding company. Services provided by MGIC to its affiliates include provision of office space and employees; administration of underwriting, risk management and claims; performance as agent for funds collection and disbursement; maintenance of investment portfolios and execution of investment transactions; maintenance of depository accounts; maintenance of books and records including financial records; and the preparation and delivery of reports, tax returns, and documents and filings as required. MGIC's direct costs and indirect expenses incurred in providing services to the individual affiliates are allocated to the respective affiliates. The Servicing Agreement is amended from time-to-time as necessary to add or delete the participation of applicable affiliated entities, and currently provides that each of the Wisconsin-domiciled MGIC insurers is a participant in the agreement.

V. REINSURANCE

The reinsurance portfolio and strategy of MGIC Reinsurance Corporation is described below. The company's reinsurance contracts contain proper insolvency provisions.

All of MGIC Re's business is derived from reinsurance of primary and pool residential mortgage guaranty insurance risks that are written on a direct basis by MGIC. The reinsurance assumed from MGIC by MGIC Re facilitates MGIC's compliance with the statutory requirements that limit a mortgage guaranty insurer's retention under a single policy of insurance to no more than 25% of debt of the mortgage borrower.

The company's old reinsurance assumption agreements, now in run-off, were for insurance risks written in 44 states and other U.S. jurisdictions which allow an insurer to recognize credit for reinsurance ceded to a subsidiary insurer. The company's business was restructured in 1996, and MGIC Re's current active business consists of reinsurance assumption of risks written on a direct basis by MGIC in 6 states (California, Kansas, Maryland, New York, Texas, and Illinois) that do not permit an insurer to recognize balance sheet credit for reinsurance that is ceded to a subsidiary insurer. Under the company's assumption treaties for the six states, MGIC Re assumes from MGIC one-third of the liability for net losses in excess of 25% of the indebtedness to the insured, subject to a maximum assumption of 25% of the indebtedness.

Until the early 1990's, the company ceded on a quota share basis to a group of foreign reinsurers. Each of the participating foreign insurers is an unauthorized reinsurer as defined in s. Ins 52, Wis. Adm. Code. Pursuant to the requirements provided in that section, the company has taken credit in its statutory annual statements for amounts ceded to unauthorized reinsurers only to the extent that such amounts are secured by funds placed in trust or by qualified letters of credit. The MGIC Re foreign reinsurance treaties are not material to the company's financial activity.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System ("IRIS") ratio results for the period under examination, and the minimum policyholder position calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

MGIC Reinsurance Corporation
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$150,558,726	\$ 0	\$150,558,726
Cash	2,032,918		2,032,918
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	12,168,144		12,168,144
Reinsurance recoverable on loss and loss adjustment expense payments	377		377
Federal and foreign income tax recoverable and interest thereon	786,499		786,499
Interest, dividends, and real estate income due and accrued	<u>1,841,223</u>	<u> </u>	<u>1,841,223</u>
Total Assets	<u>\$167,387,887</u>	<u>\$ 0</u>	<u>\$167,387,887</u>

MGIC Reinsurance Corporation
Liabilities, Surplus, and Other Funds
As of December 31, 2002

Losses	\$103,875,311
Reinsurance payable on paid loss and loss adjustment expenses	1,802,238
Loss adjustment expenses	712,938
Commissions payable, contingent commissions, and other similar charges	(4,195)
Unearned premiums	2,299,074
Ceded reinsurance premiums payable (net of ceding commissions)	6,025
Amounts withheld or retained by company for account of others	55
Payable to parent, subsidiaries, and affiliates	<u>23,397</u>
Total Liabilities	108,714,843
Common capital stock	\$ 2,000,000
Gross paid in and contributed surplus	18,000,000
Unassigned funds (surplus)	<u>38,673,044</u>
Surplus as Regards Policyholders	<u>58,673,044</u>
Total Liabilities and Surplus	<u>\$167,387,887</u>

MGIC Reinsurance Corporation
Summary of Operations
For the Year 2002

Underwriting Income

Premiums earned		\$59,750,857
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Deductions:

Losses incurred	\$8,898,766	
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Loss expenses incurred	530,874	
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Other underwriting expenses incurred	19,758,261	
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Write-ins for underwriting deductions:

Contingency reserve contribution less withdrawal	<u>29,875,429</u>	
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Total underwriting deductions		<u>59,063,330</u>
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Net underwriting gain		687,527
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Investment Income

Net investment income earned	5,592,854	
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Net realized capital gains	<u>1,185,574</u>	
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Net investment gain		<u>6,778,428</u>
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Net income before federal and foreign income taxes		7,465,955
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Federal and foreign income taxes incurred		<u>1,482,000</u>
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Net Income		<u>\$ 5,983,955</u>
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MGIC Reinsurance Corporation
Cash Flow
For the Year 2002

Premiums collected net of reinsurance	\$54,315,936
Deduct:	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	5,016,760
Underwriting expenses paid	<u>19,758,261</u>
Cash from underwriting	29,540,915
Net investment income	5,778,899
Other income (expenses):	
Net amount withheld or retained for account of others	43
Deduct:	
Federal income taxes paid	<u>2,140,758</u>
Net cash from operations	\$33,179,099
Proceeds from investments sold, matured, or repaid:	
Bonds	\$42,804,564
Stocks	3,314,950
Net losses on cash and short-term investments	<u>(27)</u>
Total investment proceeds	46,119,487
Cost of investments acquired (long-term only):	
Bonds	<u>78,122,457</u>
Net cash from investments	(32,002,970)
Cash provided from financing and miscellaneous sources:	
Net transfers from affiliates	<u>4,104</u>
Net change in cash and short-term investments	1,180,233
Reconciliation	
Cash and short-term investments, December 31, 2001	<u>852,685</u>
Cash and short-term investments, December 31, 2002	<u>\$ 2,032,918</u>

MGIC Reinsurance Corporation
Policyholder Position Calculation
December 31, 2002

Surplus as regards policyholders			\$ 58,673,044
Contingency reserve			<u>87,295,303</u>
Total policyholders position			145,968,347
Net minimum policyholders' position			
Individual loans:			
Loan-to-value more than 75%	\$55,494,240		
Loan-to-value 50 - 75%	<u>653,233</u>		
Total individual loans		\$56,147,473	
Group of Loans:			
Equity 20 - 50%, or equity plus prior insurance or deductible 25 – 55%	2,565,074		
Equity more than 50%, or equity plus prior insurance or a deductible less than 55%	<u>46,792</u>		
Total group loans		<u>2,611,866</u>	
Minimum policyholder position			<u>58,759,339</u>
Excess of total policyholders' position over minimum policyholders' position			<u>\$ 87,209,008</u>

MGIC Reinsurance Corporation
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1998	1999	2000	2001	2002
Surplus, beginning of year	\$31,072,281	\$33,689,584	\$39,709,366	\$46,221,676	\$53,539,089
Net income	2,617,303	6,019,782	6,512,310	5,959,975	5,983,955
Change in net deferred income tax				47,000	150,000
Cumulative effect of changes in accounting principles				310,438	
Surplus, end of year	<u>\$33,689,584</u>	<u>\$39,709,366</u>	<u>\$42,221,676</u>	<u>\$52,539,089</u>	<u>\$58,673,044</u>

MGIC Reinsurance Corporation
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2002

The company's NAIC Insurance Regulatory Information System ("IRIS") results for the years under examination are summarized in the following table. The unusual IRIS results during the period are denoted with asterisks, and are discussed following the table of IRIS data.

Ratio	1998	1999	2000	2001	2002
#1 Gross Premium to Surplus	53%	62%	63%	62%	103%
#2 Net Premium to Surplus	52%	62%	63%	62%	103%
#3 Change in Net Writings	65% *	40% *	17%	13%	86%*
#4 Surplus Aid to Surplus	0%	0%	0%	0%	0%
#5 Two-Year Overall Operating Ratio	88%	74%	68%	73%	84%
#6 Investment Yield	6%	5%	5%	5%	4%
#7 Change in Surplus	8%	18%	16%	14%	12%
#8 Liabilities to Liquid Assets	54%	55%	58%	61%	70%
#9 Agents' Balances to Surplus	12%	9%	14%	11%	21%
#10 One-Year Reserve Devel. to Surplus	(20)%	(28)%	(17)%	(13)%	(5)%
#11 Two-Year Reserve Devel. to Surplus	(22)%	(30)%	(31)%	(23)%	(17)%
#12 Estimated Current Reserve Def. To Surplus	(32)%	(30)%	(33)%	(43)%	(12)%

IRIS ratio number 3 evaluates the year-to-year change in an insurer's net written premium. The company's unusual results for IRIS ratio number 3 in 1998 and 1999 reflect increased volume of MGIC direct writings of deep coverages (coverages of more than 25% of the indebtedness to the insured) and corresponding increased cession to MGIC Re of such coverages. The company's unusual result in 2002 was due to increased MGIC cessions under prior reinsurance treaties, and to cessions under a new primary reinsurance treaty established

between MGIC and MGIC Re in 2002 that applies to business written for a new mortgage guaranty product produced by MGIC.

Growth of MGIC Reinsurance Corporation

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1998	\$68,203,232	\$34,513,648	\$33,689,584	\$2,617,303
1999	83,876,745	44,167,379	39,709,366	6,019,782
2000	102,278,804	56,057,128	46,221,676	6,512,310
2001	126,451,730	73,912,641	52,539,089	5,959,975
2002	167,387,887	108,714,843	58,673,044	5,983,955

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1998	\$17,709,778	\$17,645,136	\$17,926,250	23.4%	80.9%	104.3%
1999	24,724,660	24,631,742	24,635,023	(0.2)%	80.4%	80.2%
2000	28,956,806	28,919,641	29,010,994	4.1%	81.7%	85.8%
2001	32,643,467	32,605,346	31,991,663	11.4%	81.1%	92.5%
2002	60,683,721	60,639,237	59,750,857	15.8%	81.9%	97.7%

Annual net contingency reserve contributions, required due to annual changes in premiums written, are included in the expense ratio calculations reported above, and contributed to the high expense ratios experienced by the company in each of the years under examination.

During the period under examination, MGIC Re's admitted assets increased by 203%, net premiums written increased by 468%, and surplus increase by 89%. The high combined ratio in 1998 reflects the effect of a 1998 contribution of \$9 million to the company's statutory contingency reserve. The company received a paid in surplus contribution of \$5 million in 1998. The company realized net underwriting gain in each year except 1998, and had favorable net income from operations in each year reviewed by the examination.

Reconciliation of Surplus per Examination

The examination did not make any reclassification of or adjustment to year-end balances reported by the company. The company's surplus as regards policyholders as of December 31, 2002 was \$58,673,044.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the previous examination report and actions taken by the company are as follows:

1. Management and Control — It is recommended that the company's board of directors review executive decisions made on behalf of the company by the parent corporation, and that the board exercise its responsibility to manage the company by taking action on those decisions, by resolution of the company's board of directors.

Action — Compliance

2. Custody of Invested Assets — It is recommended that the company's custodial agreements expressly provide for the fiduciary obligations of the custodian, to provide that the custodian shall be obligated to indemnify the company for any loss of property of the company that is held in the custodian's custody, for loss arising from the negligence or dishonesty of the custodian's officers or employees, or for loss due to burglary, holdup, theft, or mysterious disappearance, including loss by damage or destruction. It is further recommended that the custodial agreements provide that in the event of a loss of securities for which the custodian is obligated to indemnify the company, the securities or the value of the securities at the time of the loss occurrence shall be promptly replaced, and that the value of any loss of rights or privileges resulting from said loss shall be promptly replaced.

Action — Compliance

Summary of Current Examination Results

The current examination did not result in any findings of material exception, and did not result in any recommendations requiring company action or compliance.

VIII. CONCLUSION

MGIC Reinsurance Corporation was incorporated under the laws of Wisconsin on February 21, 1985, and is a wholly owned subsidiary of MGIC Investment Corporation. MGIC Re provides excess of loss reinsurance coverage to Mortgage Guaranty Insurance Corporation on primary and pool residential mortgage guaranty insurance risks.

MGIC Re's old book of business, now in run-off, is for reinsured risks written in 1996 and prior years in all jurisdictions except for six states. The company's business was restructured in 1996, and MGIC Re's current active business consists of risks written on a direct basis by MGIC in 6 states that do not permit an insurer to recognize balance sheet credit for reinsurance that is ceded to a subsidiary insurer. Under the company's active reinsurance treaties, MGIC Re assumes from MGIC one third of the liability for net losses in excess of 25% of the indebtedness to the insured. The company cedes on a quota share basis to a group of foreign reinsurers to increase capacity. The MGIC Re foreign reinsurance treaties are not material to the company's financial activity.

The examination determined that the company is in compliance with the two recommendations that resulted from the previous examination of the company. The current examination did not result in any findings of material exception, and did not result in any reclassification of account balances or adjustment to surplus. As of December 31, 2002, the company reported net admitted assets of \$167,387,887, total liabilities of \$108,714,843, and total surplus as regards policyholders of \$58,673,887.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

The current examination did not result in any findings of material exception, and did not result in any recommendations requiring company action or compliance.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Rebecca Easland	Insurance Financial Examiner
Ryan Hanson	Insurance Financial Examiner
Tom M. Janke	Insurance Financial Examiner
Russell Lamb	Insurance Financial Examiner
Randy Milquet	Insurance Financial Examiner—Advanced

Respectfully submitted,

Thomas E. Rust
Examiner-in-Charge